



89-SBE-008

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
WILLAMETTE INDUSTRIES, INC. ) No. 83A-291-MW

Appearances:

For Appellant: Lawrence V. Brookes  
Attorney at Law

For Respondent: Jon Jensen  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666<sup>1</sup>/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Willamette Industries, Inc., against proposed assessments of additional franchise tax in the amounts of \$7,497 and \$31,307 for the income years 1977 and 1978, respectively.

1/Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

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The question presented by this appeal is whether, in computing its apportionable unitary business income, appellant may eliminate certain dividends pursuant to section 25106. The **Franchise Tax Board (FTB)** has **accepted certain of the computational revisions sought by appellant and these are not now in issue** .2/

Appellant is a major timber and forest products processor which operates both on its own account and through a number of subsidiaries. Appellant annually files a California combined report including many of its subsidiaries operating both within and without California.

Prior to 1977, a subsidiary named Brooks-Willamette (B-W) and its wholly owned subsidiary, Mobol Products, Inc. (Mobol),, were not included in appellant's combined report because appellant owned only 50 percent of B-W. Both were Oregon corporations and reported 100 percent of their income to Oregon. On June 2, 1977, appellant acquired the remaining 50-percent interest in B-W. Appellant included B-W and Mobol in its combined report beginning in the latter part of its 1977 income year. B-W paid appellant dividends of \$2,650,000 and \$7,300,000 at the end of its 1977 and 1978 income years, respectively. Mobol, through B-W, paid appellant dividends in the amounts of \$150,000 and \$750,000 for the 1977 and 1978 income years, respectively.

WI, Inc., was an Oregon corporation which, for federal income tax purposes, was a DISC. It was at all times a 100-percent-owned subsidiary of appellant. Prior to 1977, it was not included in appellant's combined report. Beginning in 1977, appellant agreed that WI, Inc., should be included in its combined report. WI, Inc., paid appellant a dividend of \$1,983,584 in appellant's 1977 income year.

In computing its apportionable business income for its 1977 and 1978 income years, appellant eliminated all of the dividend income paid to it by B-W, Mobol, and WI, Inc. upon audit, the FTB allowed the elimination of dividends only to the

2/ The parties now agree that the amounts in issue in this appeal are reduced to \$5,172 for the 1977 income year and to \$20,166 for the 1978 income year.

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extent **of the** subsidiaries' earnings and profits after they were included as part of appellant's unitary business.<sup>21</sup>

Generally, **dividends** paid by a subsidiary to its parent are includable in the parent's income in the year of distribution. (Rev. & Tax. Code, SS 24271, **subd. (a)(7)**, 24453.) An exception is made in the case of dividends paid by one corporation to another when both are engaged in a single unitary business. Section 25106 provides, in pertinent part:

In any case in which the **tax of a corporation is or has been determined under this** chapter with reference to the income and apportionment factors of another corporation with which it is doing or has **done** a unitary business, all dividends paid by one to another of such **corporations** shall, to the extent such dividends are paid out of such income **of** such unitary business, be eliminated from the income of the recipient and shall not be taken into account under section 24344 or in any other manner in determining the tax of any such corporation.

With regard to the dividends from B-W and Mobol, the parties first disagree on the interpretation of section 25106. The FTB contends that this section limits dividend elimination to dividends paid out of earnings and profits from the unitary business. Appellant argues that section 25106 allows the elimination of dividends paid from income earned at any time, including the total earnings and profits a corporation earned before it was included in a combined report as part of the unitary business.

We must agree with the **FTB's** interpretation. We find the statute, on its face, provides for elimination of dividends which are paid out of the unitary business income of the corporations engaged in **a unitary** business. Therefore, only those dividends which were paid out of business income generated in the course of the unitary business could be eliminated under section 25106.

3/ The FTB disallowed the elimination from appellant's **apportionable** business income of the following amounts:

1977 - \$58,530 of Mobol's \$150,000 dividend  
          **\$1,436,063** of B-W's **\$2,650,000** dividend  
1978 - \$576,533 of Mobol's \$750,000 dividend  
          **\$1,291,109** of B-W's **\$7,300,000** dividend  
          **\$639,970** of WI, Inc.'s **\$1,983,594** dividend

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However, appellant also argues that the non-eliminated dividends (those which were paid out of income **earned by Mobol and B-W** before they became part of the unitary business on June 2, 1977) did not **constitute apportionable** business income and must be **allocated** entirely to **Oregon, the state of appellant's commercial domicile**. We must agree with appellant on this point.

The **FTB** has essentially conceded this point by its statement at page 6 of its opening brief that 'The dividends paid from income **earned prior to the time the subsidiaries became unitary are no different than dividends paid by unrelated corporations.**' The only conclusion we can draw from this statement is that the **FTB** agrees that dividends paid from income earned before B-W and **Mobol** became part of appellant's unitary business constituted nonbusiness income to appellant. Nonbusiness dividends are allocable entirely to the recipient's commercial domicile. (Rev. & Tax. Code, S 25126.)

We have found nothing in the record which contradicts appellant's assertion and the **FTB's** concession that these dividends were nonbusiness income. There **are** no facts in the **record which** support a finding that prior to June 2, 1977, the activities of Mobol or B-W were functionally integrated with appellant's unitary business **or that the** dividends they paid were business income to appellant. Indeed, the **FTB** apparently **acquiesced, up until June 2, 1977, in the** treatment of Mobol and B-W as affiliates unrelated to the unitary **business and of** dividends paid by them as nonbusiness income allocable to Oregon. On **this** record, we must find that the dividends paid by B-W and Mobol that were not eliminated by section 25106 must, nonetheless, be excluded from apportionable business income, since they were nonbusiness income and were allocable entirely to Oregon. Having reached our decision on this basis, we need not address appellant's alternative argument regarding the interest-offset provisions.

There remains the question of the dividends paid to appellant by WI, Inc. Appellant argues that Oregon has treated WI, Inc., a DISC for federal tax purposes, as having no separate identity from appellant. Oregon has collapsed WI, Inc., into appellant and thereby eliminated the dividend for Oregon tax purposes. Appellant appears to argue that California should follow the practice of Oregon, since it is the commercial domicile of both appellant and WI, Inc. The **FTB** states that it is not obliged to follow Oregon's practice, absent a specific basis for doing so under California law. The **FTB** points out also that appellant has presented absolutely no evidence to support a finding that the separate existence of **WI, Inc.**, should be disregarded. We must agree with the **FTB**.

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Appellant has not revealed any statutory or case law authority which would require the FTB to disregard the existence of WI, Inc. In addition, appellant bears the burden of proving that the FTB's factual determination is erroneous, and this burden is not met by mere assertions. (Appeal of Joy World Corporation, Cal. St. Bd. of Equal., June 29, 1982) Appellant has **not presented** any evidence which **would justify disregarding the** determination of the FTB that WI, Inc., had a separate existence.

While we agree with the FTB's argument in the preceding paragraph, that does not end the matter. It is **true** that the dividends paid out of income other than that earned in the unitary business cannot be eliminated by disregarding the corporate existence nor, based on **our** previous discussion, can they be eliminated pursuant to section 25106. However, again based on our previous discussion, the non-eliminated dividends paid by WI, Inc., constituted nonbusiness income, and they must be allocated entirely to Oregon, just as were the non-eliminated dividends paid by Mobol and B-W.

For the reasons stated above, the action of the Franchise Tax Board must be reversed.

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O R D E R

Pursuant to the views expressed ~~in the opinion of~~ the board on ~~file in~~ this proceeding, and good cause appearing **therefor,**

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Willamette Industries, Inc. against proposed assessments of additional franchise tax in the amounts of \$7,497 and \$31,307 for the income years 1977 and 1978, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 2nd day of March, 1989, by the State-Board of Equalization, with Board Members Mr. Carpenter, **Mr. Collis**, Mr. Bennett, Mr. Dronenburg, and Mr. Davies present.

<u>Paul Carpenter</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>John Davies*, **</u>	, Member

\*For Gray Davis, per Government Code section 7.9

\*\*Abstained